United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

February 6, 2009

The Honorable Timothy F. Geithner
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Geithner:

We are writing to urge you to use your authority under the Troubled Assets Relief Program to purchase or offer credit or guarantees for certain state and municipal bonds. In our view, thawing the freeze in this part of the market would be especially vital as we seek to stimulate our economy and create jobs; these bonds are used for some of the most "shovel ready" state and local projects available across the country.

The cost of debt to state and local governments has been substantially increased as a result of the ongoing financial crisis. In particular, long-term interest rates on municipal debt increased significantly in December 2008. At one point, the rates on tax-free municipal securities actually exceeded the interest rate on taxable corporate debt of similar risk. Although the situation has seen modest improvement in recent weeks, municipal rates are still significantly higher than U.S. Treasury bond interest rates and are roughly comparable to corporate bond interest rates.

The turmoil in the credit markets has seriously affected states, cities and communities throughout the country which depend on access to the credit markets to finance critical infrastructure that is part of every-day American life: roads, schools, bridges, transit systems, waste and drinking water systems, and housing. State and local governments have suffered serious increases in their borrowing costs and have had to make decisions that will reduce economic output, shrink our job base and worsen the quality of life for millions of Americans.

The Emergency Economic Stabilization Act envisions two different programs to address our current financial instability: an asset and guarantee purchase program in Section 101 and an insurance program in Section 102. It is our assessment that either of these programs, particularly in conjunction with capital from the Federal Reserve, might be used to help restore more normal function to the municipal bond market. Prior to last year, private bond insurers played an important role in enhancing the credit ratings and marketability of municipal securities. Many of these private insurers have failed or nearly failed in the last year due to their involvement with riskier forms of financial guarantees. The municipal bond market has not recovered from these events. Section 102 of the EESA specifically authorizes the creation of an insurance program, and we would urge you to consider using this authority to directly guarantee or reinsure certain municipal securities and thus provide support to this critical market.

TARP has already been used in an array of ways that demonstrate the viability of this approach. For instance, on November 25, the Treasury announced it was allocating $20 billion of TARP funds to back a Federal Reserve Bank of New York lending facility for consumer asset-backed securities. This facility was aimed at halting a deterioration of credit availability for consumers through purchasing consumer asset-backed securities. Since municipalities are likewise suffering from a deterioration in credit availability due to the freezing of credit markets, we think there is authority and precedent for the creation of a similar facility to support certain parts of the municipal securities market under TARP. We acknowledge that defaults are possible, but with an historical default rate of 0.78% on municipal bonds between 1980 and 2006, we would not anticipate a substantial cost to this approach. Moreover, the scope can be narrowed to avoid unnecessary risk, such as by focusing on bonds which carry an underlying investment grade.

In addition, we believe that many of the problems of state and local governments related to variable rate bonds can be reduced or eliminated through the use of TARP funds to provide liquidity support for variable rate bonds of state and local governments. This support would not guarantee principal or interest on the bonds but rather would provide liquidity support for the trading market in these bonds. This extension of TARP funds would not expose the federal government to default risk and would greatly reduce the problems state and local governments are seeing with regard to expiring letters of credit and other liquidity support features for variable rate debt. As part of this effort, it would be important to confirm that the availability of federal liquidity support will not adversely affect the federal tax exemption on the bonds. Such confirmation has previously been provided in an analogous situation with regard to tax exempt money market funds and if provided in this context will promote the marketability of bonds with federal liquidity support.

We greatly appreciate your attention to this matter and are ready to work with you to make this proposal a reality. We look forward to your response.

Sincerely,

Christopher J. Dodd
Chairman

Jack Reed

Charles E. Schumer

Robert Menendez

Daniel K. Akaka

Sherrod Brown

Herb Kohl

Mark Warner

Jeff Merkley

Michael Bennet

cc: The Honorable Ben S. Bernanke